STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/25/02**	Bill No:	**AB 2897**
Tax:	**Sales and Use**	Author:	**Wiggins**
Board Position:		Related Bills:	**SB 1510 (Knight)**

BILL SUMMARY

This bill would provide a sales and use tax exemption for the sale or purchase of fuel and petroleum products sold to air common carriers to the extent the sales price exceeds $0.50 per gallon.

ANALYSIS

Current Law

Under existing law, Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that remains on board after the water common carrier reaches its first out-of-state destination. This section additionally provides a sales tax exemption for tangible personal property, other than fuel and petroleum products, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions.

With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

Proposed Law

This bill would add Section 6385.5 to the Sales and Use Tax Law to provide an exemption from the computation of the amount of the sales tax on the gross receipts attributable to a sales price in excess of fifty cents ($0.50) per gallon from the sale of fuel and petroleum products to an air common carrier. If enacted, only the first fifty cents ($0.50) per gallon when sold to an air common carrier would be subject to tax (unless, however, the air common carrier is on an international flight, in which case, the sale of fuel would be entirely exempt under current law).

The provisions of the bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill is enacted.

Background

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers' common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by AB 2181 (Stats. 1991, Ch. 85) and SB 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. Assembly Bill 3375 (Olberg) would have restored the exemption for rail common carriers. Assembly Bill 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, "Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor's proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements." The Governor's proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Two bills similar to this bill have been introduced in the past. Assembly Bill 1800 (Machado), introduced during the 1998 Legislative Session, failed to pass the Assembly Appropriations Committee. Assembly Bill 2470 (Wiggins), introduced during the 2000 Legislative Session, failed to pass the Assembly Revenue and Taxation Committee. The Board was neutral on both Assembly Bill 1800 and Assembly Bill 2470.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Air Transportation Association and Southwest Airlines.. The purpose of this bill is to create an exemption for sales of fuel to air common carriers since the exemption previously afforded to sales of fuel to air common carriers was repealed in 1991 due to budget constraints.

2. **Exemption may be difficult for retailers to administer.** The proposed exemption would apply to fuel and petroleum products only to the extent that the sales price exceeds fifty cents ($0.50) per gallon. Due to fluctuating fuel prices, the non-taxable receipts could constantly change, which could lead to difficulties for retailers in collecting the correct amount of tax and could also result in reporting errors on sales and use tax returns.

3. **Technical amendment suggested.** Since Section 6357.5 of the Sales and Use Tax Law provides that the entire sale of fuel is exempted if sold to an air common carrier on an international flight, it is recommended that "and except as provided in Section 6357.5" be added after "Section 6385," on page 2, line 3, in order to avoid any conflict.

4. **Related Legislation.** Senate Bill 1510 (Knight) would exempt from the sales tax that portion of fuel and petroleum products sold to an air common carrier that remains on board after the air common carrier reaches its first out-of-state destination The Board took a neutral position on SB 1510. Senate Bill 145 (Perata) would extend the January 1, 2003 sunset date for sales of fuel and petroleum products sold to water common carriers to January 1, 2013. The Board has voted to support SB 145.

COST ESTIMATE

Some costs would be incurred in notifying taxpayers, revising regulations and pamphlets, and answering inquiries from the public. These costs would be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

According to the U.S. Energy Information Administration (EIA), total sales of jet fuel in California for the year 2001 were 3.2 billion gallons. According to the Bureau of Transportation Statistics, total gallonage consumed in the U.S. in 2001 was 19.3 billion gallons. The fuel consumed by international flights was 5.2 billion gallons, which comprises 27 percent (5.2 billion gallons / 19.3 billion gallons) of jet fuel consumed.

Currently, expenditures on fuel for international flights are exempt from sales and use tax. Assuming that jet fuel usage in California is consistent with the national average, the fuel used for domestic flights is estimated to be 2.3 billion gallons (3.2 billion gallons X 73 percent). As of February 18, 2002, the price of jet fuel in California was $0.583 per gallon. This bill would exempt that portion of the price over $0.50 per gallon, or $0.083 per gallon. Therefore, total expenditures that qualify under this proposal are $190.9 million (2.3 billion gallons x $0.083).

Revenue Summary

The revenue impact from exempting $190.9 from the sales and use tax is as follows:

	Revenue Effect
State loss (5.00%)	$ 9.5 million
Local loss (2.25%)	$ 4.3 million
Special District loss (0.67%)	$ 1.3 million
Total loss	$ 15.1 million

Qualifying Remarks

The price of petroleum is extremely volatile. The estimate above is based upon an average of the most recent prices in California as of the week of February 18, 2002. However, if the price were to increase by $0.10 per gallon, the additional loss is estimated to be $18.2 million for a total of $33.3 million ($15.1 million + $18.2 million). However, if the price were to drop $0.10 per gallon, there would be no revenue loss.

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